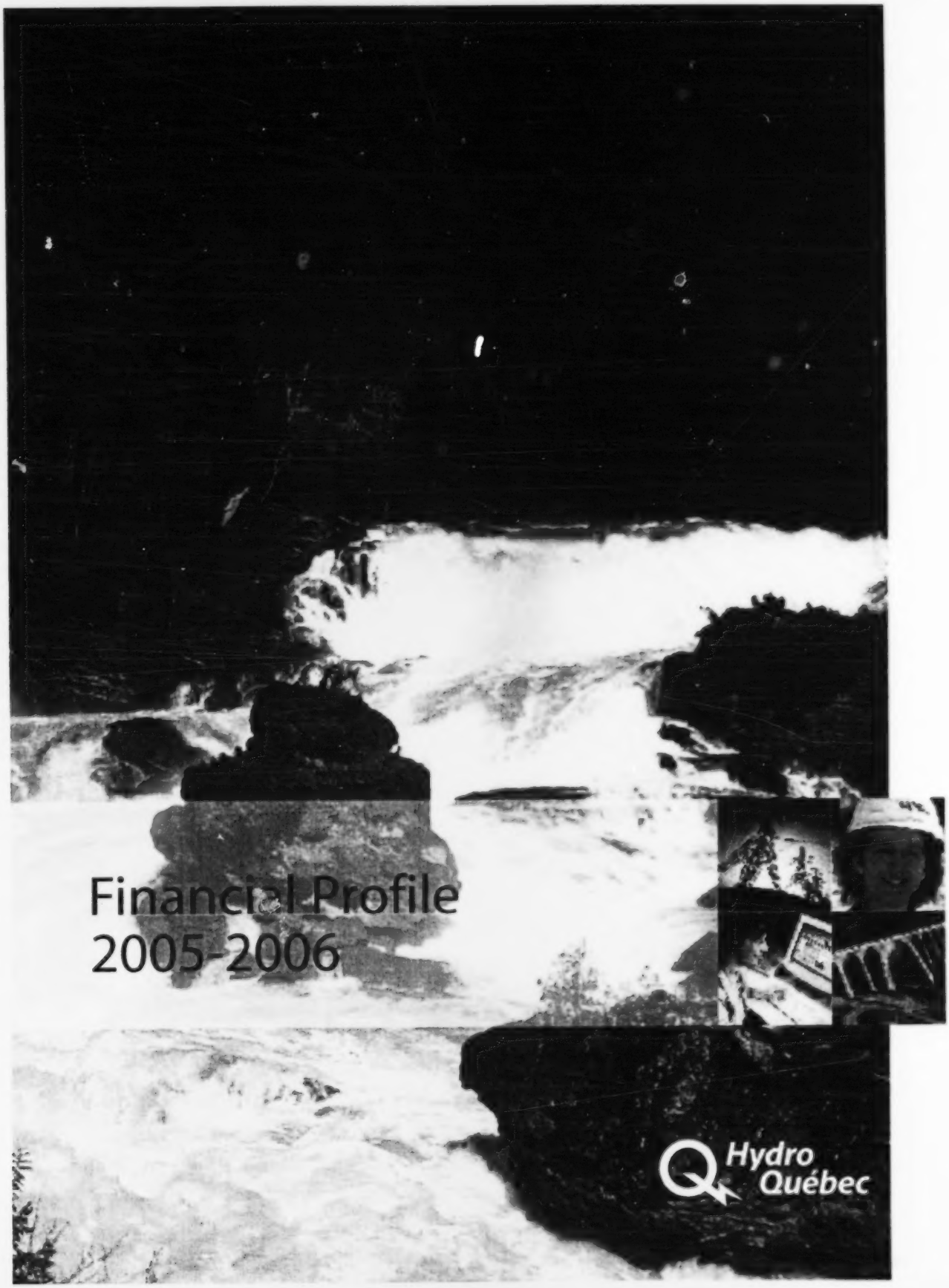
Financial Profile
2005-2006
Hydro Québec

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Prospective Information

This document contains statements of a prospective nature. They entail risks and uncertainties which may mean that Hydro-Québec's actual future results may differ considerably from those forecast. A number of risks and other factors to which Hydro-Québec is exposed may lead to changes in the results and events anticipated. These include, but are not limited to, competition, the economic environment, the business environment and Hydro-Québec's ability to achieve its strategic business objectives. Moreover, these prospective statements must in no way be interpreted as guarantees or assurances from Hydro-Québec as to its future results.

Units of Measure

kW – kilowatt (unit of voltage)
MW – megawatt (unit of power)
kWh – kilowatthour (unit of energy)
MWh – megawatthour, or one thousand kilowatthours
GWh – gigawatthour, or one million kilowatthours
TWh – terawatthour, or one billion kilowatthours
$M – millions of dollars
$B – billions of dollars

Currency

Unless otherwise indicated, monetary amounts are expressed in Canadian dollars.

Hydro-Québec is ...

Hydro-Québec generates, transmits and distributes electricity. It has the obligation to ensure a secure supply of energy for Quebecers. To meet the growing demand, it develops hydropower, with wind power added as a complementary source.

Hydro-Québec conducts energy-related research and develops new generation, transmission and distribution technologies. The company has actively promoted energy efficiency for a number of years by offering energy savings programs for all customer categories.

Hydro-Québec's sole shareholder is the Québec government, which guarantees most of its borrowings (see page 34). As at December 31, 2005, its assets totaled $60.4 billion while its long-term debt totaled $34.4 billion.

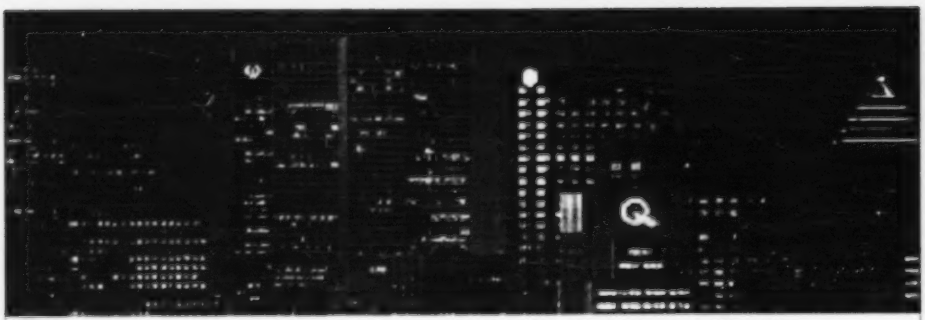
The company has four divisions:

Hydro-Québec Production
- Generates electricity.
- Supplies Hydro-Québec Distribution with an annual heritage pool of up to 165 TWh for the Québec market.
- Sells electricity on wholesale markets both inside and outside Québec.
- Carries out arbitrage and purchase/resale transactions on markets outside Québec.

Hydro-Québec TransÉnergie
- Operates the most extensive transmission system in North America for customers inside and outside Québec.
- Transmits electricity and markets the system's transmission capacity while maintaining the required reliability.

Hydro-Québec Distribution
- Is responsible for supplying Quebecers with electricity and for ensuring a reliable distribution system.
- Has access to the heritage pool, a maximum annual volume of energy (165 TWh) supplied by Hydro-Québec Production at a fixed price.
- Beyond this pool, it issues calls for tenders in a free market.
- Develops energy efficiency programs for all customer categories.

Hydro-Québec Équipement and **la Société d'énergie de la Baie James** (SEBJ, subsidiary of Hydro-Québec)
- Prime contractors in construction projects for Hydro-Québec Production and Hydro-Québec TransÉnergie.



Hydro-Québec's illuminated sign stands out atop the company's head office building in downtown Montréal.

In September 2005, I took over Hydro-Québec's Finance Department after managing major issues related to wholesale energy markets and the development of generating projects within the Hydro-Québec Production division for nearly 10 years.

This last decade has been defined by a turnaround in our financial performance and a return to major hydroelectric development projects. In May 2005, we announced that construction had begun on Chute-Allard and Rapides-des-Cœurs generating stations. In August we commissioned the 526-MW Toulnustouc generating station five months ahead of schedule. Additional hydropower projects worth nearly $5.0 billion are well under way. These projects will add more than 1,000 MW to installed capacity in Québec, for annual production of more than 6 TWh of energy. As well, the $4.0-billion Eastmain-1-A/Sarcelle/Rupert project is at the government approval stage.

Yet another of our achievements in recent years is laying the groundwork for wind power development in Québec. With hydropower and wind power, we stand firm in our choice of renewable energies for the supply of electricity in Québec. In February 2005, we signed eight contracts with *Cartier Wind Energy* and *Northland Power* to supply 990 MW of wind power. Deliveries under these 20-year contracts will begin between 2006 and 2012. In October 2005, the Distributor issued a call for tenders for an additional 2,000 MW of wind power, for which long-term deliveries should begin between 2009 and 2013. Given the intermittent nature of wind, we developed an integration service involving balancing, which has been authorized by the Régie de l'énergie (the Québec energy board). With our ability to innovate and our robust transmission grid, we intend to become the world benchmark in bringing wind power onto a major transmission grid while maintaining power quality and reliability.

It is important to note that in 2005, annual demand in Québec reached 169.2 TWh, for the first time exceeding the heritage pool of 165 TWh which Hydro-Québec Production supplies to Hydro-Québec Distribution for a fixed price. This growth is mainly attributable to a vibrant housing sector and strong industrial activity. With rising prices on energy markets, this increased demand results in higher supply costs, which puts upward pressure on electricity rates in Québec. In February 2006, the Régie authorized Hydro-Québec Distribution to raise its rates 5.33% starting April 1, 2006. However, the effects of this rate adjustment will be mitigated by our customers' substantial efforts to save energy. In September 2005, due to excellent response to our various energy conservation programs, we raised our target from 3 TWh to 4.1 TWh of savings by 2010. Achieving this objective will be beneficial not only environmentally but also economically, since it will reduce the amount of electricity we have to purchase.

In addition, we now disclose information about our reservoir levels. To ensure transparency, the Distributor also made a commitment to the Régie to publish details of the costs associated with each of its long-term contracts.

Our international strategy reflects a desire to focus efforts on our core businesses and on our ambitious capital program here in Québec. Accordingly, we have begun cutting down on our consulting activities abroad and disposing of our foreign holdings when we consider the conditions to be favorable.

Our financial performance in 2005 shows that Hydro-Québec can continue to grow in spite of higher supply costs, increased financial costs and upward pressure on pension expense.

In 2005, income from continuing operations totaled $2,249 million compared to $2,125 million in 2004. This $124 million increase is mainly due to higher net short-term exports and sales growth in Québec. However, it was mitigated by higher pension expense, depreciation and amortization, supply costs on outside markets and financial expenses.

Consolidated net income totaled $2,252 million, compared to $2,435 million in 2004. The figure for 2004 included a gain of $265 million, attributable to the sale of our interest in Noverco.

Financial expenses totaled $2,214 million in 2005, up $103 million over 2004. This variation stemmed from the recognition of a translation gain of $218 million in 2004, partially due to the application of a new accounting standard, versus a gain of $1 million in 2005.

Funds from operations rose 12.7% to $4.4 billion. These funds were mainly used to pay the dividends declared in 2004 and to fund a major portion of our investments, which amounted to $3.3 billion in 2005, compared to $3.1 billion in 2004.

Sales amounted to $10,890 million in 2005, which is $491 million more than in 2004, as a result of an increase in electricity sales both inside and outside Québec. Higher sales in Québec stemmed from growing baseload demand from industrial customers, in particular with the commissioning of Phase 2 of the Alouette aluminum smelter. The rate adjustments authorized by the Régie also had a positive effect on domestic sales. Outside Québec, sales totaled $1,464 million for 15.3 TWh in 2005, compared to $1,084 million for 14.4 TWh in 2004. This increase is mainly attributable to the high summer temperatures recorded in the U.S. Northeast.

Our borrowing program totaled $3,855 million. Our debt increased by $515 million due to our sizeable investment program and to prefinancing conducted in 2005 under advantageous market conditions.

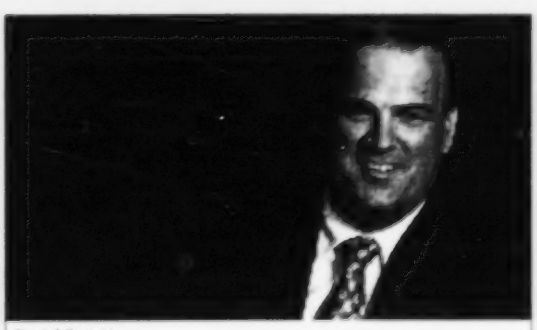
In light of our results, dividends of $1,126 million were declared. With this ninth consecutive payment, we will have paid close to $6.4 billion to our shareholder since 1998.

In 2006, Hydro-Québec is submitting a new Strategic Plan for 2006 to 2010, in which the company will aim to achieve steady growth in financial results. Our development strategy focuses on energy efficiency, the complementary nature of hydropower and wind power, and the use of new technology to optimize our service offering.

In closing, I would like to thank my predecessor, Daniel Leclair, for his major contribution to developing Hydro-Québec's Finance Department.

As this new fiscal year begins, I am confident about what the future holds. Even though we are generally satisfied with our results, we plan to continue our efforts to improve, since strengthening our financial performance remains one of our key priorities.

Daniel Garant
Executive Vice President, Finance and Chief Financial Officer



Daniel Garant

	2001	2002	2003	2004	2005
OPERATIONS (in millions of dollars)					
Revenue	11,251	11,905	10,258	10,399	**10,890**
Operating expenses	2,005	2,083	2,126	2,216	**2,294**
Electricity and fuel purchased	2,777	3,023	1,381	1,465	**1,485**
Depreciation and amortization	1,710	1,858	1,775	1,870	**2,040**
Taxes	552	540	570	609	**602**
Total expenditure	7,044	7,504	5,852	6,160	**6,421**
Operating income	4,207	4,401	4,406	4,239	**4,469**
Financial expenses	3,687	2,806	2,529	2,111	**2,214**
Income from continuing operations before non-controlling interest	520	1,595	1,877	2,128	**2,255**
Non-controlling interest	3	4	2	3	**6**
Income from continuing operations	517	1,591	1,875	2,125	**2,249**
Discontinued operations	74	(6)	63	310	**3**
Net income	591[1]	1,585	1,938	2,435	**2,252**
BALANCE SHEET (in millions of dollars)					
Total assets	58,812	59,247	57,823	58,118	**60,432**
Long-term debt, including current portion	40,405	39,515	36,011	34,517	**34,427**
Shareholder's equity	13,473	14,208	15,128	16,220	**17,376**
ANNUAL INVESTMENTS FOR CONTINUING OPERATIONS AFFECTING CASH (in millions of dollars)					
Property, plant and equipment and intangible assets	1,740	2,239	2,740	3,072	**3,282**
Other	(10)	1	(43)	(943)	**161**
Total investments	1,730	2,240	2,697	2,129	**3,443**
OPERATING STATISTICS					
Installed capacity[2] (in MW)	32,654	32,661	33,616	33,892	**34,571**
Peak power requirements[3] (in MW)	30,080	34,989	36,268	34,956	**33,636**
Total requirements[4] (in TWh)	186.6	192.9	194.8	193.0	**200.2**
Electricity sales in Québec (in TWh)	152.2	158.6	167.1	165.9	**169.2**
Electricity sales outside Québec (in TWh)	42.4	54.2	15.8	14.4	**15.3**
Total electricity sales (in TWh)	194.6	212.8	182.9	180.3	**184.5**
Number of employees	20,655	20,972	21,410	21,904	**22,131**
Number of customer accounts (in thousands)	3,557	3,597	3,644	3,701	**3,753**

Note: Certain financial and operating figures for previous years have been reclassified to reflect the presentation of the current year.

1. If not for the adjustments related to the retroactive application of the accounting standard governing foreign currency translation, the data presented would show net income of $1,108 million.
2. In addition to the installed capacity of its own generating stations, Hydro-Québec has access to most of the output from Churchill Falls, which has a rated capacity of 5,428 MW, and to all of the output from five wind farms, comprising 196 wind turbines with a total installed capacity of 210 MW.
3. Total power requirements for the winter beginning in December, including interruptible power. The 2005-2006 winter peak for Québec occurred at 6 p.m. on February 27, 2006.
4. Overall requirements comprise kilowatthours delivered in Québec and to neighboring systems.

Results by Operating Segment

		Generation	Transmission	Distribution	Construction	Corporate[1] and Other Activities	Inter-segment and Eliminations	Total
2005	Revenue							
	– External customers	1,708	28	9,181	6	16	(49)	**10,890**
	– Intersegment	4,532	2,550	55	2,053	921	(10,111)	–
	Depreciation and amortization	880	575	489	5	91	–	**2,040**
	Financial expenses	1,050	727	384	–	52	1	**2,214**
	Income (loss) from continuing operations	1,873	369	172	5	(162)	(8)	**2,249**
	Discontinued operations	–	–	58	–	(55)	–	**3**
	Net income (loss)	1,873	369	230	5	(217)	(8)	**2,252**
	Capital expenditures (including intangibles)							
	– affecting cash	1,780	793	645	6	58	–	**3,282**
	– not affecting cash	8	12	8	–	–	–	**28**
	Total assets	27,482	16,329	10,556	242	6,055	(232)	**60,432**
2004	Revenue							
	– External customers	1,293	18	8,987	9	93	(1)	**10,399**
	– Intersegment	4,607	2,529	55	1,960	890	(10,041)	–
	Depreciation and amortization	723	587	447	5	108	–	**1,870**
	Financial expenses	1,016	679	345	–	70	1	**2,111**
	Income (loss) from continuing operations	1,661	409	275	4	(171)	(53)	**2,125**
	Discontinued operations	–	–	12	–	298	–	**310**
	Net income (loss)	1,661	409	287	4	127	(53)	**2,435**
	Capital expenditures (including intangibles)							
	– affecting cash	1,820	586	601	12	53	–	**3,072**
	– not affecting cash	350	10	6	–	–	–	**366**
	Total assets	26,469	16,056	10,279	246	5,295	(227)	**58,118**

1. This heading includes corporate activities, mainly financial services, human resources, corporate affairs, and the activities of the Shared Services Centre (such as procurement, computer services and corporate telecommunications). It also covers the activities managed by Hydro-Québec Technologie et développement industriel, that is, research, technical support, industrial development of Hydro-Québec technologies, and capital venturing. The activities of Hydro-Québec International and of Hydro-Québec Pétrole et gaz are also included.

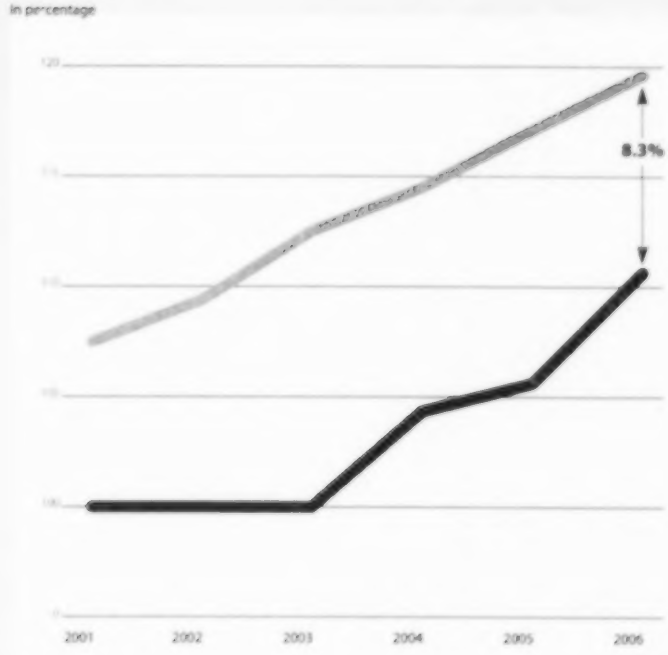
	2001	2002	2003	2004	2005	Forecast 2006
FINANCIAL RATIOS						
Coverage ratios						
Interest coverage[1]	1.44	1.61	1.70	1.77	1.95	1.89
EBITDA interest coverage[2]	1.77	2.28	2.43	2.68	2.86	2.75
Liquidity ratios						
Net cash flow to fixed assets and intangible assets[3] (in %)	153.0	134.9	109.1	89.0	78.3	86.6
Self-financing[4] (in %)	50.6	72.8	57.3	75.3	56.9	79.0
Funds from operations to average total debt[5] (in %)	8.4	8.0	8.8	9.7	10.5	11.5
Profitability ratios						
Return on revenue from continuing operations[6] (in %)	4.6*	13.4	18.3	20.4	20.7	22.0
Return on equity[7] (in %)	4.4*	11.5	13.2	15.5	13.4	13.9
Capital structure ratios						
Capitalization[8] (in %)	24.8	26.2	29.8	32.8	34.2	35.9
Average cost of debt[9] (in %)	8.6	7.7	7.7	6.8	7.6	8.1
DECLARED DIVIDENDS (in millions of dollars)	554	763	965	1,350	1,126	1,250

Note: The financial data have been restated following retroactive application of the standards for currency translation as well as for asset retirement obligations.

* If not for the adjustments related to the retroactive application of the accounting standard governing foreign currency translation, the data presented would show a return on revenue from continuing operations of 9.2% and a return on equity of 7.6%.

1. Sum of operating income and net investment income divided by gross interest expense.
2. Earnings before interest, taxes, depreciation and amortization divided by gross interest expense.
3. Cash provided from operations less dividends paid by fixed assets and intangible assets.
4. Cash provided from operations less dividends paid, divided by sum of investments, long-term debt maturities and sinking fund redemptions.
5. Net income before extraordinary items, depreciation and amortization, AFUDC and deferred income taxes divided by the sum of long-term debt, perpetual debt, non-controlling interest, short-term borrowings and current portion of long-term debt (yearly average).
6. Income from continuing operations divided by revenue.
7. Net income divided by average shareholder's equity.
8. Shareholder's equity divided by sum of shareholder's equity, long-term debt, perpetual debt, short-term borrowings and current portion of long-term debt, less swaps and sinking funds.
9. Sum of gross interest, net loss (gain) on repayment of long-term debt and exchange loss (gain) (before restatement) and guarantee fees divided by sum of long-term debt, perpetual debt, short-term borrowings and long-term debt payable within one year (annual average), less swaps and sinking funds.

Electricity Rates and CPI 2001-2006



In its decision rendered in February 2006, the Régie de l'énergie authorized the Distributor to recover its additional revenue requirement for 2006 by increasing its rates by an average of 5.3% as of April 1, 2006. Moreover, the Régie recognized the increase in supply costs and the importance for electricity rates to reflect this reality. The rates were frozen from 1998 to 2004.

	2001	2002	2003	2004	2005	2006
Increase in Canadian consumer price index (CPI) Cumulative index (1998 = 100)	107.2	109.5	112.6	114.7	117.2	119.6
Hydro-Québec rates Cumulative index (1998 = 100)	100.0	100.0	100.0	104.5	105.7	111.3

In 2005, electricity sales increased by 3.3 TWh or 2% compared to 2004, due, among other things, to an increase in industrial production and strong housing starts.

Comparative Index of Electricity Prices in 2005

Residential Customer Accounts at April 1, 2005
(Montréal = 100)

Monthly bill for a consumption of 1,000 kWh (taxes excluded)

Industrial Customer Accounts at April 1, 2005
(Montréal = 100)

Monthly bill (taxes excluded) for a demand of 10 MW, a consumption of 5,760 MWh and a load factor of 80%

* At January 1, 2005

Sources: Hydro-Québec, *Comparison of Electricity Prices in Major North American Cities, April 1, 2005* and EURELECTRIC, *Electricity Tariffs as of 1 January 2005 (Published Tariffs)*.

The Craig and Gosford Roads touristic route was developed thanks to Hydro-Québec's Integrated Enhancement Program, which is used to fund initiatives to enhance human and natural environments in communities affected by a major transmission project. Craig Road, which opened in 1810, and Gosford Road, which opened in 1832, were the first road link between Quebec City and Boston.

Average Price of Electricity by State (2004) and Province (2003)

Overall average in USC/kWh

Source: Energy Information Administration, *Electric Power Annual* 2004, November 2005.

Source: Statistics Canada, *Electric Power Generation, Transmission and Distribution*, 2003 (57-202-XIB), March 2005.

Highest and lowest rate zones

- ■ >9.0 USC/kWh: Northeast States and California
- ■ <4.5 USC/kWh: Mostly hydroelectric regions

Energy sources for power generation in the United States (2004)

50%	1,979 TWh	Coal
20%	789 TWh	Nuclear
18%	709 TWh	Natural gas
7%	268 TWh	Hydroelectric
3%	121 TWh	Oil
3%	105 TWh	Other

Energy sources for power generation in Canada (2003)

61%	33... TWh	Hydroelectric
18%	102 TWh	Coal
13%	71 TWh	Nuclear
4%	24 TWh	Natural gas
2%	14 TWh	Oil
1%	7 TWh	Other

Régie de l'énergie

Established in 1996, the Régie is a board whose mission is to reconcile the public interest, consumer protection and the fair treatment of the transmission provider and energy distributors in Québec.

Transmission and distribution operations are regulated by the Régie de l'énergie on the basis of cost of service. Generation does not come under the Régie's jurisdiction. However, under the related legislation, Hydro-Québec Production is required to supply Hydro-Québec Distribution with a heritage pool of 165 TWh at a fixed price of 2.79¢/kWh.

Hydro-Québec TransÉnergie

In April 2006, the Régie approved a transmission rate adjustment retroactive to January 1, 2005; the new rates had previously been declared provisional as of that date. The cost to Hydro-Québec Distribution was raised by $170 million, because of its increased transmission needs. The Régie recognized a rate of return on equity of 8.58% for 2005.

Hydro-Québec Distribution

In March 2005, the Régie authorized a 1.2% rate increase for Hydro-Québec Distribution effective April 1, 2005, and recognized a return on equity of 8.71% for 2005. For the 2006–2007 rate year, the Régie has authorized an average rate increase of 5.33% starting April 1, 2006, and has recognized a 7.96% return on equity for 2006.

Effects of Rate Regulation on the Consolidated Financial Statements

Regulation has an impact on the Corporation's financial results. In fact, the net income reported in the consolidated financial statements takes into account regulatory practices that are accepted by the Régie and that result in the recognition of regulatory assets. "Regulatory assets" refers to costs, incurred during the year or preceding years, which the Corporation expects to recover from customers through the rate-setting process.

The following table presents the net carrying amounts of these assets as at December 31:

	Expected years of recovery	2005	2004
Net costs related to retirement of property, plant and equipment and intangible assets	2006-2015	258	239
Costs related to the Energy Efficiency Plan	2006-2010	131	51
Costs related to the rescission of dual-energy Rate BT	2006-2011	76	21
Costs related to a major discontinued project	2006-2007	20	–
Cost variance related to electricity purchases in excess of heritage pool	Conditions to be determined by the Régie	13	–
		498	**311**

These costs are generally charged to separate accounts and are amortized over several years according to the method specific to each category. If transmission and distribution activities in Québec were not regulated, net income for 2005 would be reduced by $187 million due to the recognition of these costs.

The risk and uncertainty related to regulatory assets are subject to periodic monitoring and assessment. When the Corporation considers that the value of these regulatory assets is no longer likely to be recovered through the rate-setting process, the carrying amount of these assets is charged to operations for the year in which this judgment is made.

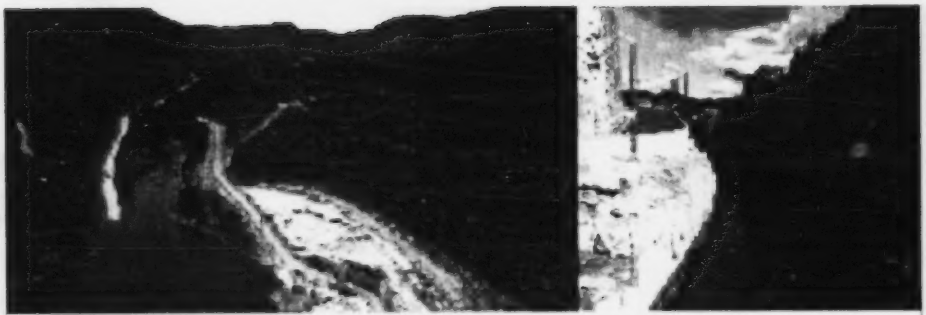
Security of Supply for Quebecers

Since 2001, Hydro-Québec Distribution has had to file an Electricity Supply Plan with the Régie de l'énergie every three years. This plan describes how the Distributor intends to meet domestic market needs. The Electricity Supply Plan 2005–2014, filed on November 1, 2004, is the second such plan.

Moreover, the Distributor is required to report on the progress made regarding this plan no later than November 1 of the first and second years after it is filed. This document presents the results achieved and discusses the adequacy of supply based on the criteria set down in the Plan. It also presents an updated native load forecast. The first progress report on the Electricity Supply Plan 2005–2014 was filed in October 2005.

Highlights

- Since the Plan was filed in November 2004, the Distributor has signed nine long-term supply contracts and more than 60 short-term contracts, all following calls for tenders.
- In 2006, the Distributor will purchase electricity on short-term markets to meet needs from April to December 2006.
- Other than the latest call for tenders now in process (2,000 MW of wind power), the Distributor does not expect to issue any other long-term calls for tenders to meet firm needs for energy and power before its next Electricity Supply Plan is filed in November 2007.
- The domestic sales forecast between now and 2014 has been revised downward slightly from the Electricity Supply Plan 2005-2014. With the new targeted energy savings to be reached by 2015, as proposed in the Québec Energy Strategy 2006-2015, annual sales are now expected to reach 180.6 TWh. The average annual growth rate will be 0.7%, or 1.3 TWh per year.
- Most of the growth forecast (62%) is attributable to the industrial sector, in particular the resumption of activity at the ABI aluminum smelter, which was affected by a strike in 2004, and the expansion of the Alouette aluminum smelter in Sept-Îles. This expansion project alone represents some 4.3 TWh of the forecast growth.
- When forecast losses on the distribution and transmission systems are added to sales forecasts, energy needs in 2014 will total 197.6 TWh. Supply needs are based on this forecast.
- A total of 41,435 MW of power will be required between now and 2013–2014, an increase of 295 MW from the Electricity Supply Plan 2005–2014. This rise is mainly due to increased sales in the "General and institutional" and "Residential and farm" segments, as electricity improved its competitive position and the housing market continued strong. However, other factors, such as the rise of the Canadian dollar and higher energy-savings targets in the EEP, have caused the Industrial segment's power needs to be revised downward.



Hydro-Québec inaugurated Toulnustouc generating station on August 18, 2005, five months ahead of schedule. It has an installed capacity of 526 MW and will have an average annual output of 2.7 TWh. This project, which was carried out in partnership with the Betsiamites Band Council and the Manicouagan RCM, completes the Manic-Outardes complex. Work on the project began in November 2001.

Long-Term Contracts Awarded by Tender

Supplier	Capacity	Delivery	Region	Type
Hydro-Québec Production	350 MW baseload	March 1, 2007	Northern Québec	Hydroelectricity
Hydro-Québec Production	250 MW cycling	March 1, 2007	Northern Québec	Hydroelectricity
Trans-Canada Energy	507 MW baseload	September 1, 2006	Bécancour	Cogeneration
Kruger Inc.	19 MW	July 1, 2007	Sherbrooke	Forest biomass cogeneration
Bowater Canadian Forest Products	20.4 MW	July 1, 2006	Gatineau	Forest biomass cogeneration
Cartier Wind Energy Inc.	739.5 MW	December 1, 2006	Gaspé Peninsula	Wind
Northland Power	250.5 MW	December 1, 2007	Gaspé Peninsula	Wind
Tembec Inc.	8.1 MW	December 15, 2008	Témiscamingue	Forest biomass cogeneration

MAKES BUSINESS SENSE

Energy Efficiency

Since 2005, power consumption by Quebecers has exceeded the 165 TWh per year set aside for the heritage pool. To ensure the energy security of Québec, therefore, the company must purchase additional electricity at market prices, which inevitably puts upward pressure on rates.

At the same time, the company is continuing its efforts to encourage customers to use electricity more wisely. Hydro-Québec Distribution is continuing to invest in energy conservation programs that enable it to better control supply costs for the benefit of the division and all of its customers.

More and more Québec customers are adopting the energy conservation measures being promoted by Hydro-Québec to reduce their electricity bill and contribute to sustainable development.

Energy Conservation Target Raised to 4.7 TWh

As proposed in the Québec Energy Strategy 2006-2015, Hydro-Québec Distribution will revise its Energy Efficiency Plan (EEP) and increase its annual conservation target, to be achieved by 2010, from 4.1 TWh to 4.7 TWh, in line with the

Bringing Wind Power onto the Grid

Hydro-Québec expects to have 3,500 MW of wind power under contract by the end of 2013. This represents more than 7% of the total installed wind power capacity in the world today.

Due to the intermittent nature of wind, integration services are needed whenever wind power is brought onto a hydropower-based transmission grid. This service, for which an agreement has been signed between Hydro-Québec Distribution and Hydro-Québec Production, applies to contracts to supply 990 MW of wind power which were approved by the Régie de l'énergie on July 22, 2005.

The integration agreement has two components:

- A balancing service to offset the effects of the intermittent nature of wind, and therefore of wind generation, on the Hydro-Québec transmission grid
- A firming service that will ramp up capacity to match each megawatt of wind power purchased by the Distributor.

This agreement will ensure the optimal integration of wind facilities for Hydro-Québec Distribution. The overall cost of balancing and firming services is estimated at 0.5¢/kWh and will bring the average supply cost for wind power to 8.3¢/kWh.

As the agreement has been approved by the Régie de l'énergie, the integration service will be in effect for the first deliveries in December 2006.

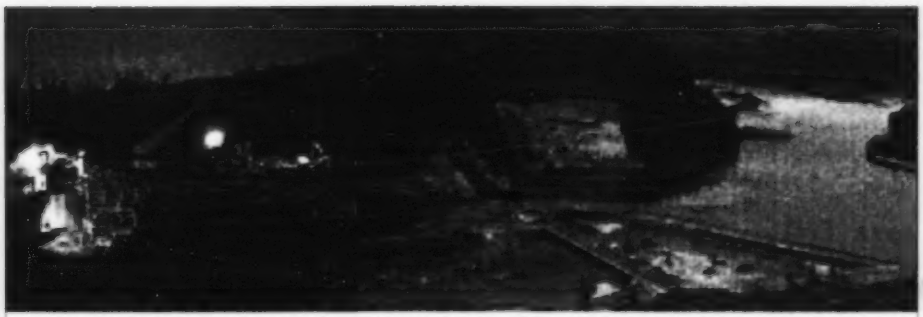
target of 8 TWh to be achieved by 2015. The various programs and investments will be presented to the Régie de l'énergie in the coming months.

The EEP includes several programs designed for each of the company's customer categories. Hydro-Québec Distribution has made these programs more attractive by offering more financial assistance for more products and by ensuring that measures dovetail better with the action taken by the Québec Agence de l'efficacité énergétique, the federal Office of Energy Efficiency, and industry partners.

The EEP also includes specific measures for low-income customers and new measures for off-grid system customers.

PROJECTS UNDER CONSTRUCTION

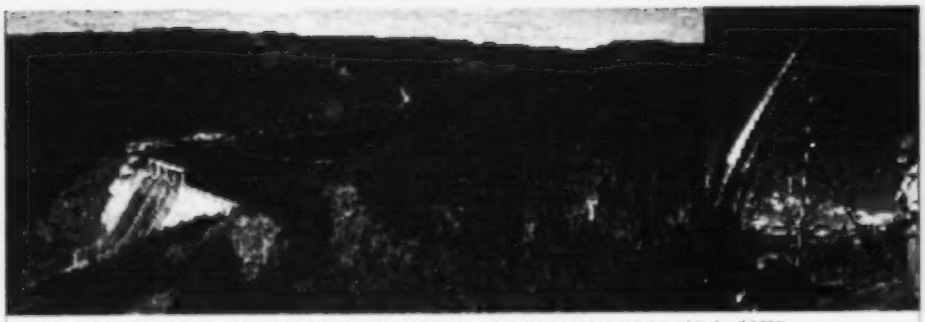
Generating stations and developments	Commissioning	Construction	Capacity	Energy	Investment
Mercier generating station Region: Outaouais Carried out by: Hydro-Québec Équipement	2006	2002-2006	51 MW	0.3 TWh	$140 million
Eastmain-1 hydroelectric development Region: Northern Québec Carried out by: Société d'énergie de la Baie James	2006-2007	2002-2007	480 MW	2.7 TWh	$2.2 billion
Péribonka hydroelectric development Region: Saguenay–Lac-Saint-Jean Carried out by: Hydro-Québec Équipement	2008	2004-2008	385 MW	2.2 TWh	$1.4 billion
Chute-Allard and Rapides-des-Cœurs hydroelectric developments Region: Mauricie Carried out by: Hydro-Québec Équipement	2007-2008	2005-2008	138 MW	0.9 TWh	$691 million
PROJECTS UNDER STUDY					
Eastmain-1-A and Sarcelle powerhouses and Rupert diversion Region: Northern Québec	2009-2012		888 MW	8.5 TWh	$4.0 billion
Romaine Complex Region: Minganie	2014 and beyond		1,500 MW	7.7 TWh	$6.6 billion



As at December 31, 2005, after 21 months of work, the economic spin-offs from the Péribonka hydroelectric development project total $254 million. This amount will increase to $345 million by the time construction is completed in 2008. There could be between 1,200 and 1,300 workers on the site in 2006, when work will be the most intense. The generating station is scheduled to be commissioned in 2008.

PROJECTS UNDER CONSTRUCTION

Connections, integration into the transmission system and new substations	Commissioning	Investment
Integration of power from wind parks (990 MW) following Hydro-Québec Distribution's first call for tenders for wind power	2006-2012	$348.3 million
Arnaud substation (supply for Phase 2 –Alouette aluminum plant)	2006	$32.2 million
Connection of hydroelectric development: Eastmain-1	2006	$145.7 million
Donnacona substation (reconstruction)	2006	$20 million
Integration of power from Trans-Canada Energy following Hydro-Québec Distribution's call for tenders	2006	$41 million
Connection of hydroelectric developments: Chute-Allard and Rapides-des-Cœurs	2007	$104.5 million
Connection of hydroelectric development: Péribonka	2008	$184.5 million
Saraguay substation	2008	$38.9 million
PROJECTS UNDER STUDY		
Saint-Lin substation (new substation)	2008	
New 1,250 MW interconnection with Ontario	2009	
Bourassa II substation (new substation)	2009	
Chomedey substation	2009	
Integration of power from wind farms (2,000 MW) following Hydro-Québec's Distribution's second call for tenders for wind power	2008-2013	
Communauté urbaine de Québec substation	2010	
Connection of Eastmain-1-A and de la Sarcelle generating stations	2010	
Connection of Romaine Complex	2013-2016	



The 315-kV line linking Toulnustouc generating station to Micoua substation was commissioned in April 2005.

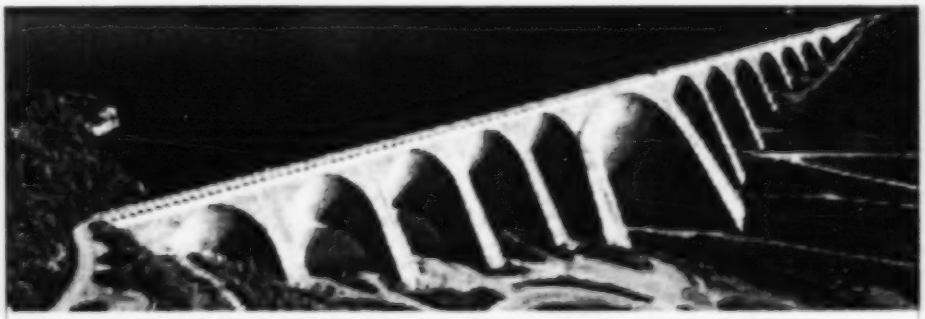
Location of Projects

Field campaigns are being carried out in connection with draft-design studies for the Romaine complex to list the features of the natural and human environments. The draft-design studies should be completed in the fall of 2006.

Generating Facilities 2005

	Commissioning date	Capacity (in megawatts)
Hydroelectric[1]		
Robert-Bourassa	1979-1981	5,616
La Grande-4	1984-1986	2,779
La Grande-3	1982-1984	2,418
La Grande-2-A	1991-1992	2,106
Beauharnois	1932 and 1961	1,667
Manic-5	1970-1971	1,528
La Grande-1	1994-1995	1,436
Manic-3	1975-1976	1,244
Bersimis-1	1956-1959	1,125
Manic-5-PA	1989-1990	1,064
Manic-2	1965-1967	1,024
Other (43 plants under 1,000 MW, including Lac-Robertson owned by Hydro-Québec Distribution)	1910-2005	10,292
		32,299
Nuclear generating station		
Gentilly-2 (nuclear)	1983	675
Thermal generating stations (conventional)		
Tracy (oil-fired)	1964-1968	600
Bécancour, La Citière and Cadillac (gas-turbine)	1976-1993	870
Other (24 diesel units)[2]	1946-2001	125
		2,270
Wind farm		
Saint-Ulric (3 wind turbines)	2001	**2**
Total installed capacity[3]		**34,571**

1. The installed capacity shown for the generating stations reflects winter turbine operating conditions (water temperature at 5°C).
2. Owned and operated by Hydro-Québec Distribution.
3. In addition to the installed capacity of its own generating stations, Hydro-Québec has access to most of the output from Churchill Falls, which has a rated capacity of 5,428 MW, and to all of the output from five wind farms, comprising 196 wind turbines with a total installed capacity of 210 MW.



Daniel-Johnson dam, which stands 214m high, is the largest multiple-arch-and-buttress dam in the world.

QUÉBEC
Generating station rated 300 MW or more
Generating station under construction
735-kV substation
450-kV direct-current line
735-kV line
Interconnection
Neighboring system facility
HUDSON BAY
JAMES BAY
QUÉBEC
La Grande-2-A
La Grande-1
Robert-Bourassa
La Grande-3
La Grande-4
Laforge-2
Brisay
Laforge-1
Eastmain-1
Sainte-Marguerite-3
Manic-5-PA
Manic-5
TO CHURCHILL FALLS G.S. (INTERCONNECTION)
Toulnustouc
Manic-3
Manic-2
Outardes-4
Outardes-1
Outardes-3
Péribonka
Bersimis-1
Bersimis-2
ST. LAWRENCE RIVER
Chute-Allard
Rapides-des-Cœurs
Trenche
Mercier
Gentilly-2
Bécancour
Tracy
Carillon
Beauharnois
ONTARIO
LAKE ONTARIO
NEW YORK
VERMONT
NEW HAMPSHIRE
UNITED STATES
MAINE
NEW BRUNSWICK
PRINCE EDWARD ISLAND
NOVA SCOTIA
ATLANTIC OCEAN
MASSACHUSETTS
R.I.
CONNECTICUT
PENNSYLVANIA
NEW JERSEY

Since 2000, Hydro-Québec Production has been active on wholesale power markets via an energy trading floor with approximately 100 employees.

In addition to supplying the heritage pool of electricity to Hydro-Québec Distribution, the trading floor works to create value from our generating assets by selling surplus power and carrying out purchase/resale transactions on spot markets outside Québec. Our reservoirs enable us to purchase and store electricity and then resell it at a higher price.

The trading floor also handles forward contracts and electricity swaps and implements various arbitrage strategies to benefit from favorable price variances between markets.

Selling electricity on markets outside Québec is one of our strategic activities and is a major source of revenue. Between 2000 and 2005, net electricity exports contributed $4.6 billion to net income.

Hydro-Québec plays a key role in power interchanges between markets in the U.S. Northeast, Ontario and the Atlantic provinces, particularly during the summer months when exports help meet the strong demand for electricity.

Energy Trading Risks

The credit and market risks relating to trading floor operations are systematically monitored and strictly managed. A team of ten specialists equipped with state-of-the-art information systems sees to the application of the necessary checks and balances for wholesale markets and analyzes the financial positions of counterparties.

This team, which reports to the Executive Vice President, Finance and Chief Financial Officer, must quantify credit and market risks and ensure compliance with the limits approved by senior management and the Board of Directors.

Activity on Hydro-Québec Production's energy trading floor

Hydro-Québec uses an integrated approach to risk management. Each division has set up a rigorous process to determine and manage the risks inherent in its activities. These risks are consolidated into a business portfolio managed by the Management Committee, here acting as the Risk Management Committee, which reports to the Board of Directors.

Financial Risks

The financial risks associated with volatility in three key parameters, namely interest rates, exchange rates and aluminium prices, are subject to the active integrated management of market and credit risks. The objective is to limit the impact of adverse changes in these factors according to criteria determined each year on the basis of the Corporation's risk tolerance.

Generation

Hydro-Québec Production manages its risk in an environment in which the principal uncertainty arises from weather conditions, more specifically, natural runoff. To meet its heritage pool and firm contract obligations, the division must always be able to cover a natural runoff deficit of 64 TWh over two consecutive years, and 98 TWh over four consecutive years. Its strategy is based on the multi-year management of energy reserves and on maintaining an adequate margin between generating capacity and contractual commitments. The division also manages energy trading risks (see page 19).

Transmission

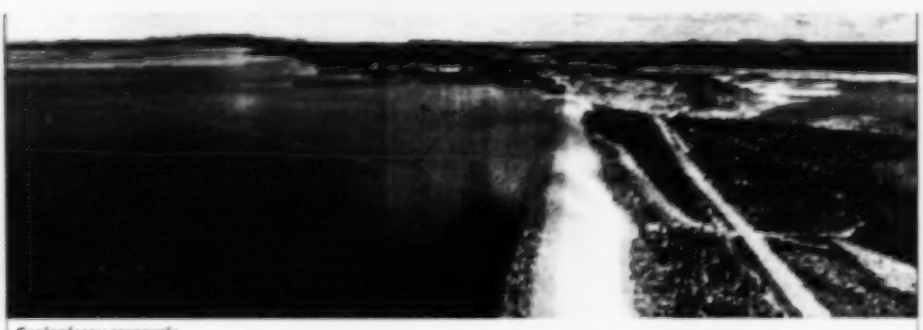
Hydro-Québec TransÉnergie practices integrated risk management, taking the necessary steps to successfully handle the winter peak and prevent major power failures. To do this, the division deploys different means of securing its facilities and ensuring their long-term operability, and conducts all its activities in accordance with the increasingly strict reliability standards set by the appropriate North American authorities.

Distribution

Hydro-Québec Distribution manages risk in an environment where electricity supply costs, capital spending and pension expense are all rising significantly. It takes all appropriate steps to mitigate the risks that could affect its profitability, especially those related to supply, to the Energy Efficiency Plan, and to recognition of all its costs by the Régie de l'énergie.

Construction

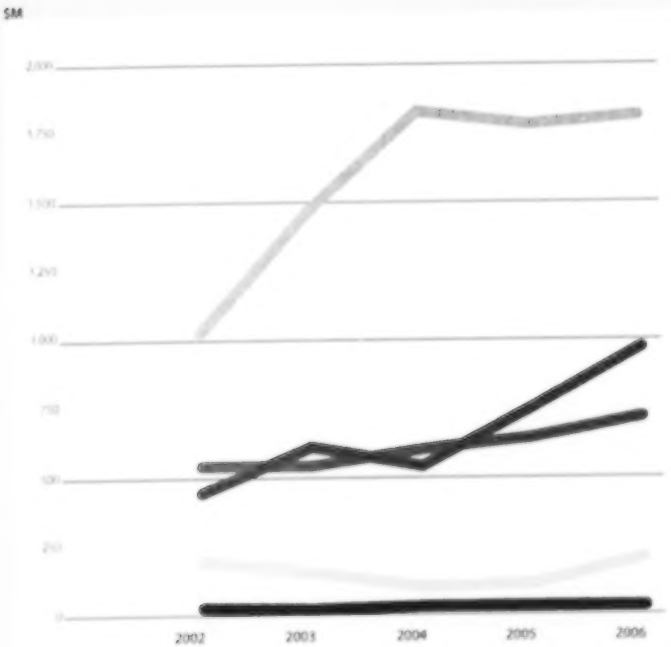
Québec's construction industry is working at full capacity, which is putting upward pressure on the cost of Hydro-Québec Équipement and SEBJ construction projects. Moreover, the future volume of activity for Hydro-Québec's Construction segment hinges on obtaining government approval for major projects like the Eastmain-1-A/Sarcelle/Rupert project.



Caniapiscau reservoir
Pursuant to its commitment to the Régie de l'énergie, Hydro-Québec now discloses information about its energy reserves.

Investments in Property, Plant and Equipment and Intangible Assets 2002-2006

(affecting cash)



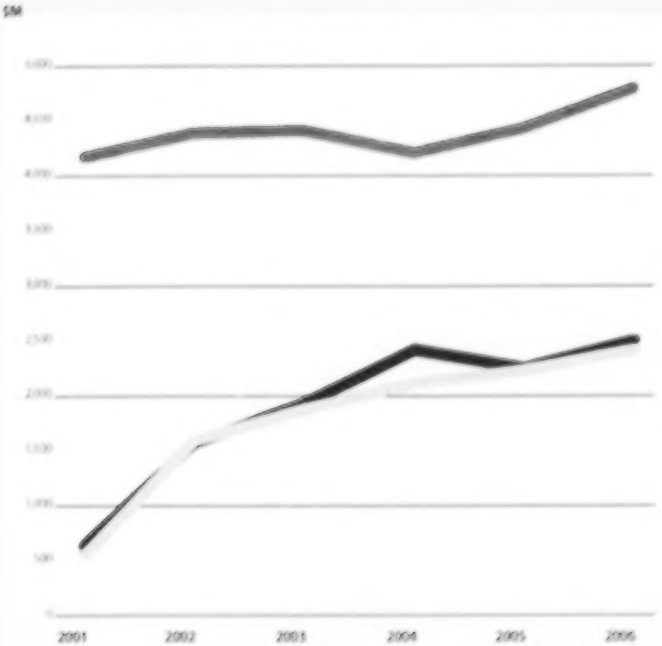
The high volume of capital outlay, which totaled $3.3 billion in 2005 versus $3.1 billion in 2004, reflected Hydro-Québec's continued activity in major projects in the Generation and Transmission segments. Hydro-Québec intends to invest almost $4 billion in 2006. Close to 60% of this amount will be devoted to development projects.

					Forecast
Generation	1,018	1,428	1,820	1,780	1,813
Distribution	540	540	601	645	725
Transmission	459	610	541	722	991
Corporate and Other Activities[1]	213	158	98	129	216
Construction	9	4	12	6	7
Total	**2,239**	**2,740**	**3,072**	**3,282**	**3,752**

1. This heading includes corporate activities, mainly financial services, human resources, corporate affairs and the activities of the Shared Services Centre (such as procurement, computer services and corporate telecommunications). It also covers the activities of the Groupe Technologie (formerly Hydro-Québec Technologie et développement industriel), that is, research and technical support, industrial development of Hydro-Québec technologies, capital venturing, as well as telecommunications activities (since February 2006). The activities of Hydro-Québec International are also included.

Construction on Eastmain-1 hydroelectric development project, located in the James Bay Territory

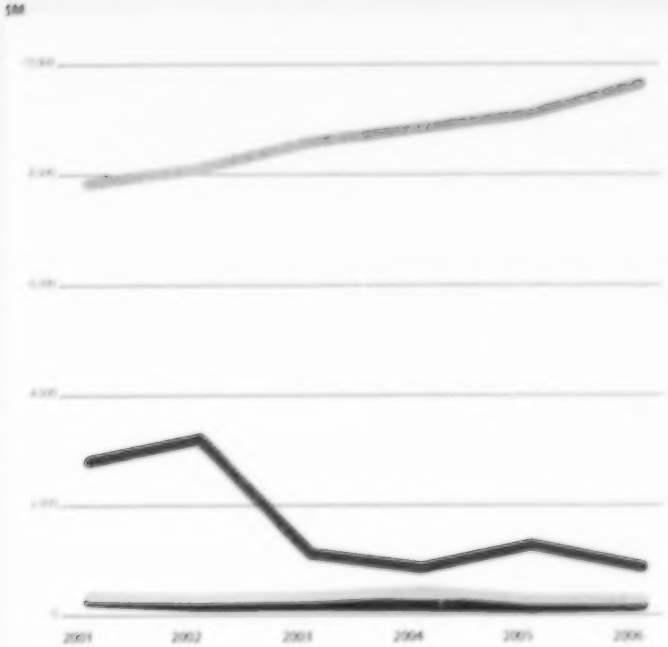
Income 2001-2006



In 2006, net income for Hydro-Québec should be slightly higher than in 2005. Growth in revenue from domestic sales and from net sales outside Québec will be partially offset by higher pension expense and financial expense as well as increased supply costs for Hydro-Québec Distribution.

	2001	2002	2003	2004	2005	2006 Forecast
Operating income	4,207	4,401	4,406	4,239	4,469	4,776
Net income	591	1,585	1,938	2,435	2,252	2,500
Income from continuing operations	517	1,591	1,875	2,125	2,249	2,453

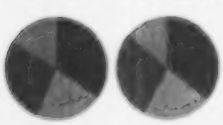
Revenue 2001-2006



Revenue for 2005 rose 4.7% over 2004. This increase can be credited to good performance on external markets and greater revenue from electricity sales in Québec as a result of demand growth and rate adjustments.

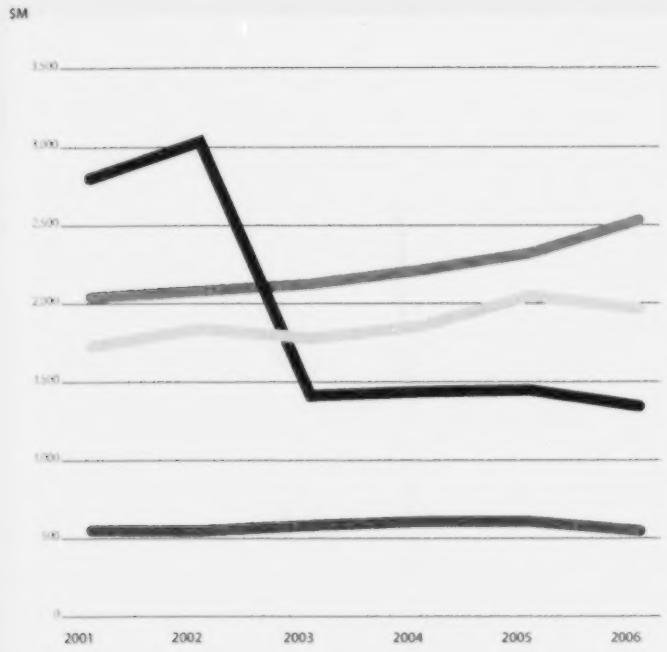
						Forecast
Electricity sales in Québec	7,803	8,112	8,578	8,922	9,121	9,676
Electricity sales outside Québec (short-term)	2,794	3,233	1,138	905	1,290	982
Other revenue	366	327	335	393	305	304
Electricity sales outside Québec (long-term)	288	233	207	179	174	199
Total	**11,251**	**11,905**	**10,258**	**10,399**	**10,890**	**11,161**

Breakdown of electricity sales revenue by customer category



	2005	2006
Residential and farm	34.7%	35.9%
General and institutional	21.7%	21.9%
Industrial	27.4%	28.9%
Other, including sales outside Québec	16.2%	13.3%

Expenditure 2001-2006

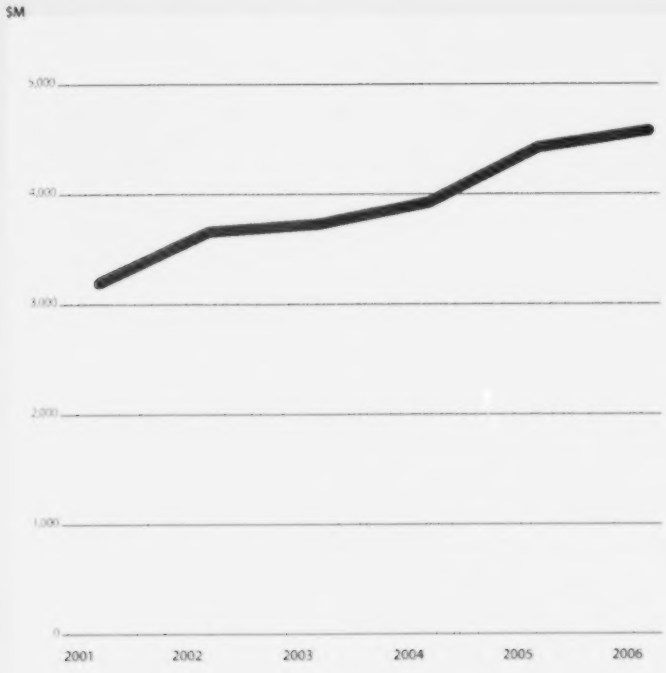


Total expenditure was $6,421 million or $261 million (4.2%) more than in 2004. Operating expenses rose $78 million (3.5%) because of the increase in pension expense ($144 million). If this item had been excluded, operating expenses would have been 3% lower than in 2004.

	2001	2002	2003	2004	2005	2006 Forecast
Electricity and fuel purchased	2,777	3,023	1,381	1,465	1,485	1,346
Operations	2,005	2,083	2,126	2,216	2,294	2,515
Depreciation and amortization	1,710	1,858	1,775	1,870	2,040	1,978
Taxes	552	540	570	609	602	546
Total	**7,044**	**7,504**	**5,852**	**6,160**	**6,421**	**6,385**

Hydro-Québec entered into a partnership with the municipality of James Bay in January 2005 regarding the Eastmain-1-A/Sarcelle/Rupert project. Hydro-Québec will pay $310 million over 50 years to this community starting when the necessary approvals to carry out the project are obtained.

Funds from Operations 2001-2006

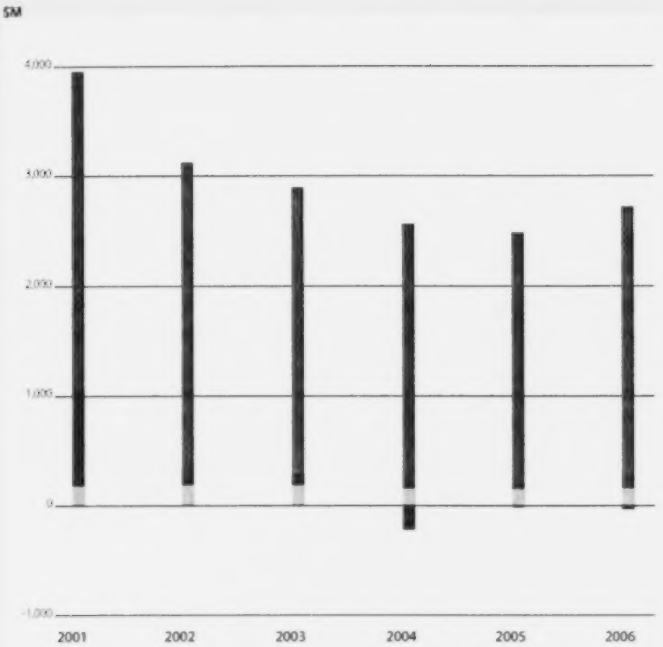


In 2005, funds from operations rose 12.7% to $4.4 billion. These funds enabled us to pay the dividends declared in 2004 and to finance a large portion of our investments.

	2001	2002	2003	2004	2005	2006 Forecast
■ Funds from operations	3,191	3,653	3,759	3,923	4,423	4,566

On November 29, 1965, the first 735-kV transmission line in the world, linking the Manic-Outardes complex and Lévis substation, was commissioned. This technology is the legacy of Jean-Jacques Archambault, a Hydro-Québec engineer, who died in 2001.

Financial Expenses 2001-2006



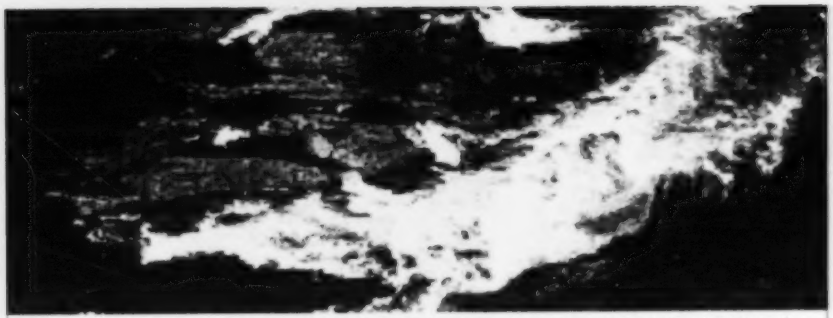
Financial expenses for 2005 rose 4.9% over 2004, chiefly because of the foreign exchange gain recognized in 2004 following a revaluation of the natural hedge between debts and sales in U.S. dollars.

						Forecast
■ Interest	2,909	2,738	2,596	2,408	2,331	2,564
■ Exchange (gain) loss	885	202	120	(218)	(1)	(21)
■ Loan guarantee fees	185	187	185	162	156	158
Less						
Capitalized financial expenses	248	299	347	226	249	333
Net investment income	44	22	25	15	23	45
Total	**3,687**	**2,806**	**2,529**	**2,111**	**2,214**	**1,945**

Beauharnois generating station dates back to 1932. With an installed capacity of 1,667 MW, it is the fifth-largest generating station in Québec, although it remains one of the largest hydroelectric generating stations in the world. Rehabilitation work to this generating station began in 1994 and will be completed in 2009. The work involves overhauling and modernizing generating units, constructing new buildings and refitting lines to a 120-kV capacity.

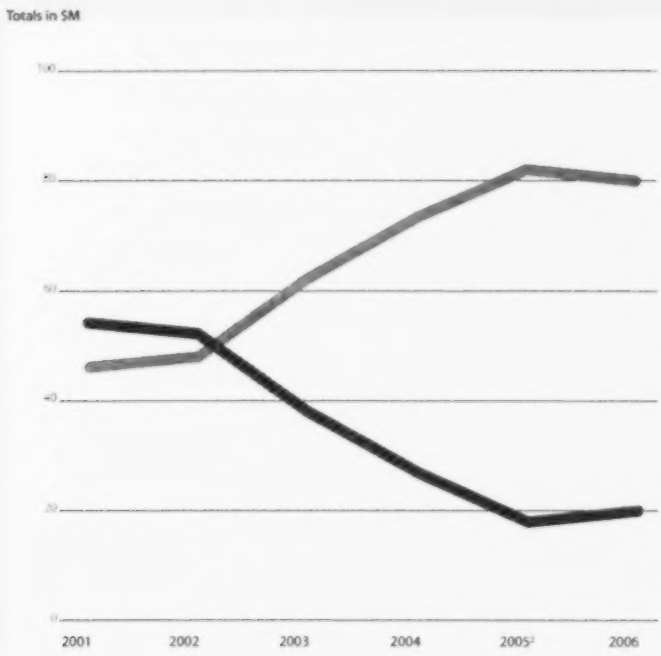
Financing Objectives and Strategies

FINANCING AND DEBT MANAGEMENT	Objectives	Strategies
	1. Maintain the presence and impact of Hydro-Québec in the capital markets.	• Stagger debt maturities in order to maintain the annual financing program at a stable level. • Focus on strategically important capital markets, in particular the Canadian bond market. • Plan bond issuance in order to establish liquid benchmarks.
	2. Diversify Hydro-Québec's funding sources while minimizing foreign exchange risk.	• Maintain access to foreign capital markets, particularly the U.S. dollar and Euro markets. • Use swaps to hedge foreign financing in currencies other than the U.S. dollar. • Secure financing in the lowest-cost market.
	3. Manage Hydro-Québec's debt effectively.	• Maintain the percentage of floating-rate debt at approximately 20%. • Redeem debt prior to maturity whenever possible, if such operations allow Hydro-Québec to reduce the cost of its debt.



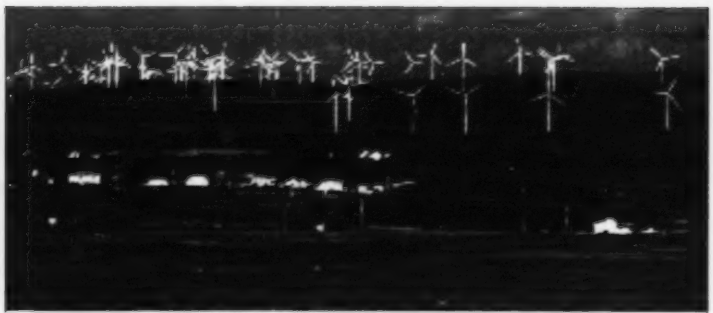
Hydro-Québec Équipement will construct two new hydroelectric development projects totalling 138 MW in the Upper Mauricie region. The Chute-Allard and Rapides-des-Cœurs development projects will be commissioned in 2007-2008.

Breakdown of Debt by Repayment Currency 2001-2006[1]



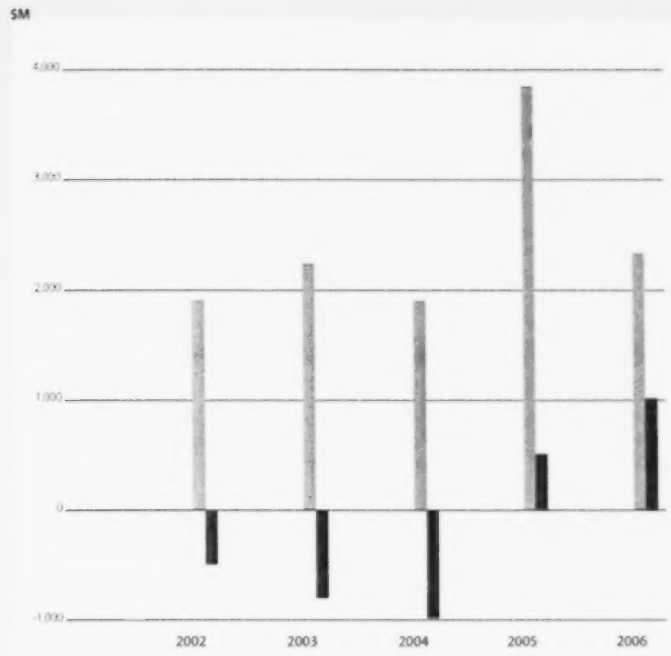
	2001	2002	2003	2004	2005[2]	2006 Forecast
U.S. dollars	53.9%	52.0%	37.9%	26.5%	17.8%	20.0%
Canadian dollars	46.1%	48.0%	62.1%	73.5%	82.2%	80.0%
Total	**37,684**	**36,999**	**32,917**	**31,582**	**31,858**	**32,744**

1. Debt of Hydro-Québec, excluding subsidiaries and holdings. The debt described here excludes perpetual debt. For more details, see table on page 33. The debt is translated into Canadian dollars at the closing exchange rates in effect at the balance sheet date.
2. Exchange rate: CA$/US$1.1659



Le Nordais wind farm in Cap-Chat on the Gaspé Peninsula.

Financing Needs 2002-2006[1]



In 2006, considering debt maturities, funds generated by operations and the plan for creating value from our foreign holdings, our borrowing program will total $2.3 billion.

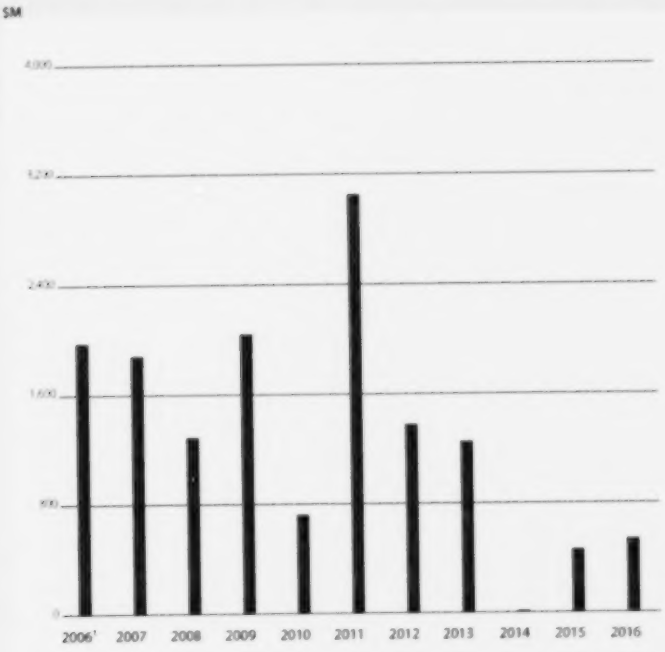
					Forecast
Gross borrowing	1,918	2,248	1,916	3,855	2,341
Net borrowing (or repayment)	(495)	(797)	(979)	515	1,019

1. The analysis deals with the financing activities of Hydro-Québec, excluding its subsidiaries and holdings.

Market

Canadian	65.6%	100%	100%	100%	100%
Global American	34.4%				

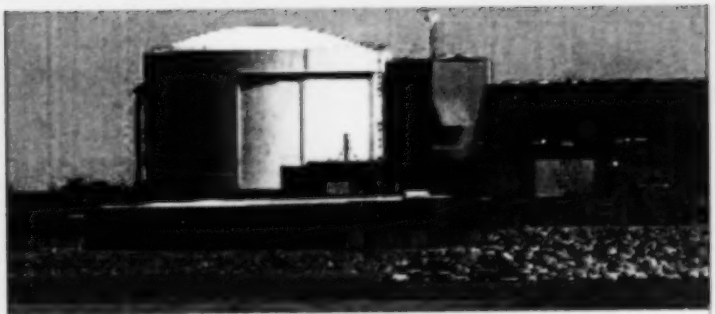
Debt Maturities 2006-2016



Our strategy is to stagger debt maturities in order to maintain the annual financing program at a stable level.

	2006¹	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
■ Debt Maturities²	1,975	1,880	1,286	2,039	724	3,050	1,381	1,254	16	462	543

1. Excludes series IO US$1,000 million, 8.05%, maturing in 2024 and redeemable at the option of the holder in 2006.
2. Excluding sinking funds and swaps that are assets related to debt.



Hydro-Québec Production is examining the possibility of modifying spent fuel storage facilities and overhauling the Gentilly-2 nuclear power plant. This 675-MW plant was commissioned in October 1983 and supplies close to 5 TWh of power annually, which is approximately 3% of Hydro-Québec's power grid.

QUÉBEC-ONTARIO 1990-2006

Source: Hydro-Québec

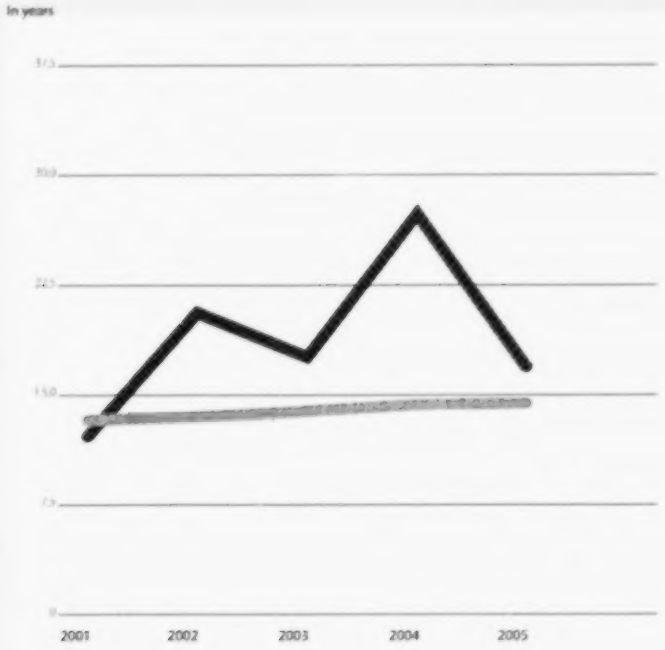
CANADA-QUÉBEC 1990-2006

Source: Hydro-Québec

The long-term performance of Québec's credit spreads shows a clear positive trend. The spreads remain at a level close to the best values recorded during the period observed.

In July 2005, the Régie de l'énergie authorized Hydro-Québec Distribution to implement the distribution system automation project presented in March 2005. This project is aimed at reducing the number of hours of service interruption in targeted areas by operating some 3,750 breakers and switches on approximately 1,100 lines on the power grid via remote control. It will be carried out between 2005 and 2008.

Average Maturity of Debt 2001-2005[1]

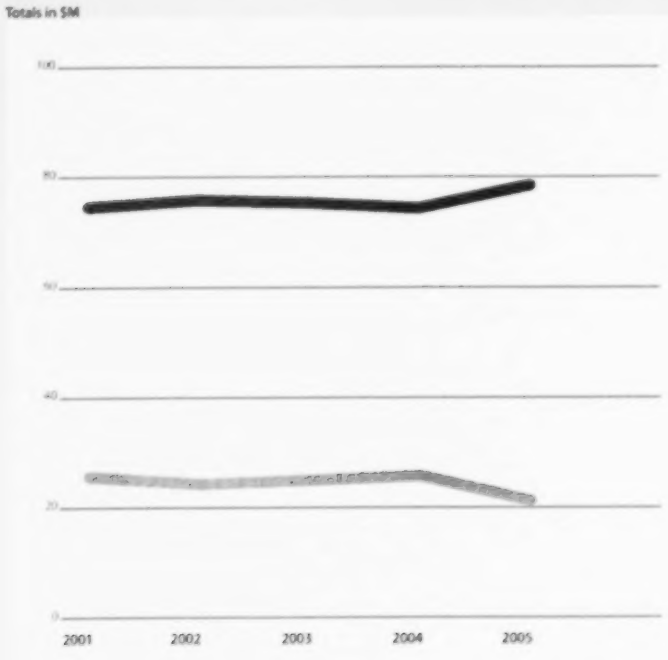


	2001	2002	2003	2004	2005
■ Average maturity of borrowings for the year	12.2	20.5	17.5	27.3	16.9
▦ Average maturity of debt	13.2	13.5	13.9	14.5	14.8

1. The analysis deals with the financing activities of Hydro-Québec, excluding its subsidiaries and holdings.

The La Grande complex, in the James Bay Territory.

Breakdown of Total Debt by Fixed and Floating Rate 2001-2005[1]



	2001	2002	2003	2004	2005
■ Fixed-rate debt (%)	74.5	75.7	75.2	74.3	79.9
▨ Floating-rate debt (%)	25.5	24.3	24.8	25.7	20.1
Total	**38,236**	**37,631**	**33,357**	**31,973**	**32,237**

1. The analysis deals with the financing activities of Hydro-Québec, excluding its subsidiaries and holdings. The debt is translated into Canadian dollars at the closing exchange rates in effect at the balance sheet date.
2. Exchange rate: CAN/US$ 1.1659

Evolution of components of total debt 2001-2005[1]

(in millions of dollars)

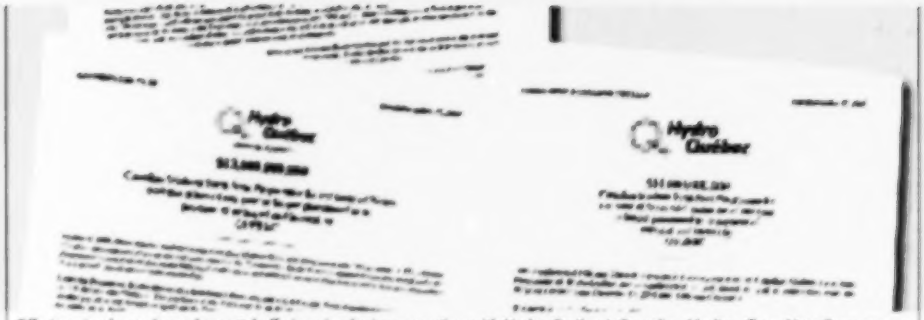
	2001	2002	2003	2004	2005[2]
Long-term debt	35,030	34,573	32,292	31,387	31,151
Current portion of long-term debt	3,055	2,761	1,609	1,908	3,141
Swaps and sinking funds (short and long-term)	-401	-335	-984	-1,71	-2,434
Perpetual debt	552	632	440	391	379
Total debt	**38,236**	**37,631**	**33,357**	**31,973**	**32,237**

Guarantee of the Corporation's Debt and Credit Ratings

The Corporation's long-term debt in 2005 includes $32,014 million in debentures and medium-term notes that are guaranteed unconditionally and irrevocably by the Québec government. Short-term financial instruments, such as commercial paper and standby lines of credit, are also guaranteed by the government.

Certain private placements, capital leases and swaps, totaling $2,278 million, are not guaranteed by the Québec government.

CURRENT CREDIT RATINGS	Long-term debt	Commercial paper
Moody's	A1 positive	P-1
Standard and Poor's	A+ stable	A-1+
Fitch Ratings	AA- stable	F1+
Dominion Bond Rating Service	A stable	R-1 (low)

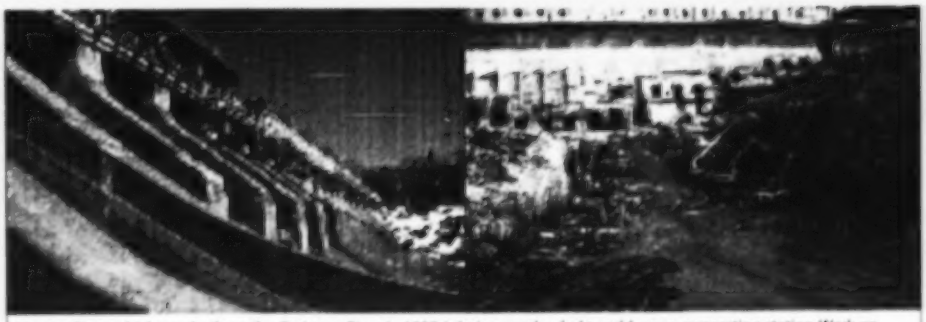


Offering circular and supplemental offering circular in connection with Hydro-Québec's Canadian Medium Term Note Programme.

Preauthorized Financing

Type of financing	Volume authorized	Market	Maturity	Outstanding at December 31, 2005
Lines of credit	US$350 million or C$350 million		1 year	
	C$40 million		1 year	
	US$110 million		1 year	
Standby lines of credit[1]	US$750 million		2011	
	US$750 million		2011	
Commercial paper[1]	US$2,250 million or C$ equivalent	United States Canada	Max. 364 days Max. 365 days	C$20.1 million
Medium-term notes[1]	US$3,000 million or equivalent in other currencies	United States	9 months or longer	US$620.7 million
	US$4,000 million or equivalent in other currencies	Euromarket	1 month or longer	US$1,270.9 million
	C$14,000 million	Canada	1 year or longer	C$11,411.1 million

1. Guaranteed by the Québec government.



Mercier Dam, which was built on the Gatineau River in 1927, is being overhauled to add a new generating station. Work on Mercier generating station began in the spring of 2004. The station will generate 282 GWh of power annually, roughly equivalent to the annual consumption of 14,000 homes. The generating units should be put into operation in the spring of 2006.

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Legal deposit – 2nd quarter 2006

Library and Archives Canada
Bibliothèque et Archives nationales du Québec

ISSN 0821-1760
ISBN 2-550-46390-0
ISBN 2-550-46391-9 (PDF)
2006G025 A

Ce document est également publié en français.

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